

IN THE HIGH COURT OF JUDICATURE AT MADRAS

DATED :: 29-01-2007

CORAM

THE HONOURABLE MR.JUSTICE P.D.DINAKARAN

AND

THE HONOURABLE MRS.JUSTICE CHITRA VENKATARAMAN

TAX CASE (APPEAL) No.6 OF 2007

Commissioner of Income Tax,  
Chennai.

....

Appellant

-vs-

M/s.Brilliant Tutorials Pvt.Ltd.,  
12, Masilamani Street,  
T.Nagar,  
Chennai-600 017.

....

Respondents

Appeal against the order, dated 18.08.2006, made in ITA No.2749/Mds/2005, on the file of Income Tax Appellate Tribunal, Madras 'A' Bench for the Assessment Year 2002-2003 against ITA No.246/2005-2006/A-III dated 24.11.2005 on the file of the Commissioner of Income Tax (Appeals)-III Chennai against PA GIR No.Ex6-055/AABCB2768C dated 28.3.2005 on the file of the Assistant Commissioner of Income-Tax Company Circle(1) (2), Chennai.

For appellant : Mr.J.Narayanaswamy

J U D G M E N T

(Judgment of the Court was delivered by CHITRA VENKATARAMAN,J.)

Revenue is on appeal against the order of the Tribunal.The appeal relates to the assessment year 2002-2003.

2. Following are the questions of law raised in this appeal

:

(1)Whether on the facts and circumstances of the case, the Tribunal was right in holding that as long as the

assessee writes off a debt as bad debt, the question whether it was indeed a bad debt should not be gone into ?

(2) Whether on the facts and circumstances of the case, after the amendment of Sec.36, an assessee is entitled to claim deduction in respect of any debt written off as bad ?

(3) Whether on the facts and circumstances of the case, the Tribunal was right in permitting the assessee to claim expenditure on advertisement in one year, while the matching fee receipts were spread over more years ?, and

(4) Whether on the facts and circumstances of the case, the assessee is entitled to follow a system of accounting which is not in accordance with the matching principle ?

3. The assessee is a company engaged in the business of running a tutorial for professional entrance examinations. On 28.03.2000, it took over the business of the company, First Computers. The assessee claimed a sum of Rs.51,57,365/- as bad debt, being the amount due from the franchisee of First Computers. It is stated that the main business of First Computers was to impart computer education and it had collected security deposits from various franchisees. It is stated that the business, however, slowed down and worsened due to the tragic incidents in USA in the year September, 2001. Faced with this situation, and that the franchisees had closed down their business the assessee was left with no other option except to write off the dues from the franchisees. The assessee filed a detailed statement, showing the names of the franchisees, the amount due from them, the security deposit adjusted and the net amount written off. Such course was adopted by the assessee, on the contention that there had been a serious fall in the income earned by these franchisees. They also felt that the closure of the business by the franchisees had also motivated them to write off as bad debt.

4. The assessing authority took the view that the assessee company had taken a unilateral decision of closing the accounts of the franchisees and thereby claimed the debts as bad. Hence, the assessing authority rejected the plea and disallowed the claim of bad debts, thus resulting in addition of a sum of Rs.51,57,365/- to the assessee's total income.

5. Aggrieved of the above, the assessee preferred an appeal before the Commissioner of Income Tax (Appeals) - III. In the course of hearing before the first appellate authority, the Commissioner of Income Tax called for a report from the assessing officer, wherein it

was stated that mere writing off of the amount from the assessee's books of accounts as a bad debt was not acceptable and, hence, unless and until the assessee proved that the debt really became a bad debt and in the absence of any satisfactory proof to that extent, the claim, as such, could not be granted. The first appellate authority, by his order, dated 24.11.2005, confirmed the order of the assessing authority, stating that there was no considerable force in the submission of the assessee.

6. The aggrieved assessee preferred a further appeal before the Tribunal. The Tribunal considered the decision relied on by the Revenue in the case of CIT v. Micromax Systems Pvt.Ltd., (277 ITR 409 (Mad), and South India Surgical Co.Ltd. v. ACIT, (153 Taxman 491), and pointed out that as against the total receipts from the franchisees at Rs.51,47,980/- in the year 2000-2001, there was a considerable fall in the year 2001-2002 at Rs.11,63,247/-; that considering such a huge fall in the business, there was a clear cut case of bad debts and after the amendment of Section 36 (1) (vii), writing off such bad debt would entitle the assessee to claim deduction that an assessee was not required to prove anything beyond except the honest judgment on the part of the assessee to sustain the claim. Under the circumstances, the Tribunal allowed the plea of the assessee. On the second aspect regarding the expenditure incurred on advertisement in one year and the matching fee spread over for more than one year as well as the question of the system of accounting, which is not in accordance with the matching principle, the Tribunal noted that the assessee was collecting the fee in advance and the receipts were split over the duration of the entire course. The Assessing Officer observed that the entire expenditure relating to advertisement expenses should be allowed only in a year, in which the receipts had been booked, which should be in accordance with the matching principle. The Tribunal held that the decision of the Apex Court in the case of *Madras Industrial Investments Corporation Limited v. CIT.*, 225 ITR 802 (Mad), could not be applied to the facts herein and the benefit of expenditure on advertisement would not be available on a specified future period. The Tribunal further held that the benefit would be available for a long period of time, but such period of time could not be defined by any method. The Tribunal also rejected the reliance placed on the assessee's own case for the earlier years, on the ground that the assessee was following the cash system then. Going by the language of Section 37 (1) it is clear that it does not impose any condition except those that are explicitly set out in the provision that the expenditure is laid out exclusively for the purpose of business and that expenditure being revenue in character, the mere fact that the assessee might have derived benefit in future years could not stand in the way of granting the relief on the expenditure incurred on advertisement. The Revenue has preferred this appeal on this ground also.

7. Learned Standing Counsel appearing for the Revenue submitted that the view of the Tribunal that the assessee would be entitled to the relief on the claim of bad debt by a mere writing off without any evidence to support the same would be totally unsustainable in law. He further submitted that amendment to Section 36 does not empower the assessee to write off any amount to claim it as an automatic deduction as a bad debt. He also submitted that while the assessee had been spreading the income over the years, the deduction is claimed in the year of expenditure itself. It is also stated that the assessee neither followed the mercantile system nor cash system of accounting and that after 1997-98, the option is only either cash system or mercantile system. Under the circumstances, the learned Standing Counsel prayed for rejection of the view of the Tribunal.

8. Section 36 (1) (vii) was amended w.e.f. 01.04.1989. The relevant provision reads as follows :

"subject to the provisions of sub-section (2), the amount of any bad debt or part thereof which is written off as irrecoverable in the accounts of the assessee for the previous year." (emphasis supplied)

9. A perusal of the order of the assessing authority shows that as a matter of fact there had been a fall in the receipts of income through franchisees. Referring to the details of the income, it was stated that the assessee had been receiving sufficient amount by way of advance in the form of security deposits and, hence, there was no reason for the assessee to have bad debts for the assessment year 2002-2003 of such a huge magnitude. It was further stated that after the take over of First Computers, the assessee company had withdrawn from the business and took a unilateral decision of closing their accounts and claimed it as bad debts.

10. A perusal of the details given before the Assessing Officer shows that there had been an actual fall in the receipts, which is said to be due to the crash in the USA, having a serious impact on the business carried on. A commercial decision to close down the business was taken and thereby the account closed as part of the decision. There is no denial of this fact from the revenue. As such, factually there is nothing for the revenue to suspect the motive for writing off the debt. Quite apart from this, by reason of the Direct Tax Laws Amendment Act 1987, the question as to whether the debt has become bad or doubtful is a factual one. With the amendment that is brought in w.e.f. 01.04.1989, even taking the view that the benefit could not be claimed as an automatic concomitant of writing off, an honest judgment made at that time when the assessee wrote off the debt, in the light of the events leading to that stage,

could not be found fault with. Under the circumstances, the claim made in terms of Section 36 (1) (vii) can not be rejected.

11. Having regard to the scope of Section 36 (1) (vii) and the commercial decision, which persuaded the assessee to write off, we do not find any question of law arising from the order of the Tribunal, for admission.

12. Learned counsel appearing for the Revenue placed reliance on *Commissioner of Income-Tax v. Micromax Systems P.Ltd.*, (2005) 277 ITR 409 (Mad), a decision of this Court, relating to the assessment year 1997-98. While considering the amendment, this Court held that after 01.04.1989, it is a mandatory condition that deduction actually written off and not just made as a provision, would be allowed as a bad debt.

13. Explaining the amendment, the Board issued a Circular No.551, dated 23<sup>rd</sup> January, 1990, which read as follows:

"The old provisions of clause (vii) of sub-section (1) read with sub-section (2) laid down conditions necessary for allowability of bad debts. It was provided that the debt must be established to have become bad in the previous year. This led to enormous litigation on the question of allowability of bad debt in a particular year, because the bad debt was not necessarily allowed by the Assessing Officer in the year in which the same had been written off on the ground that the debt was not established to have become bad in that year. In order to eliminate the disputes in the matter of determining the year in which a bad debt can be allowed and also to rationalise the provisions, the Amending Act 1987, has amended clause (vii) of sub-section (1) and clause (i) of sub section (2) of the section and to provide that the claim for bad debt will be allowed in the year in which such a bad debt has been written off as irrecoverable in the accounts of the assessee. "

Hence, given the understanding by the Board to the provisions also, this appeal fails.

14. On the second issue regarding the advertisement charges, it is seen that the assessee had changed its accounts maintenance from cash system to mercantile system. The Assessing Officer rejected the claim, on the ground that the advertisement expenses claimed by the assessee did not match the receipts. Hence,

he took the view that a portion of the expenditure relating to the advertisement expenses should be allowed only in the year in which the receipts had been booked. Such method would be a perfect match of accounting the income and expenditure.

15. The first appellate authority, however, held that the stand of the assessee did not fit into the matching concept of income and expenditure and, hence, confirmed the disallowance. As far as this claim is concerned, it is not denied that the expenditure incurred was for the purpose of business and the possible benefit in future does not mitigate the claim for expenditure in present time. Hence, considering the scope of Section 37, the Tribunal correctly held that the assessee was entitled to the deduction sought for.

16. When once it is admitted that the expenditure is of revenue in nature and incurred fully and exclusively in the business, a further enquiry as to whether the income has flown thereon from the expenditure, would not be a justifiable ground for rejection. On the other hand, an expenditure satisfying the character as revenue expenditure should be allowed in the assessment.

17. In the decision in Commissioner of Income-Tax v. Southern Roadways Ltd., reported in (2006) 282 ITR 379 (Mad), this Court, to which one of us was a party (Justice P.D.D), referring to a decision of the Division Bench in CIT v. Southern Roadways Ltd., reported in (2004) 265 ITR 404, considered the scope of Section 37 and held that any expenditure not being in the nature of capital expenditure or personal expenses but laid out or expended wholly and exclusively for the purpose of business or profession, should be allowed.

18. As to the third question raised, the Revenue had not made a specific issue before the Tribunal, except to contend that the claim of expenditure in one year and spreading over the income in future years would amount to a hybrid system of accounting not in accordance with the matching principles. However having regard to our decision as stated above, we do not find any justification to admit this appeal.

19. In view of what is discussed above, this appeal is dismissed at the threshold.

Sd/  
Asst.Registrar

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Sub Asst.Registrar

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To

1. THE ASSISTANT REGISTRAR,  
INCOME TAX APPELLATE TRIBUNAL,  
RAJAJI BHAVAN,  
BESANT NAGAR, CHENNAI.

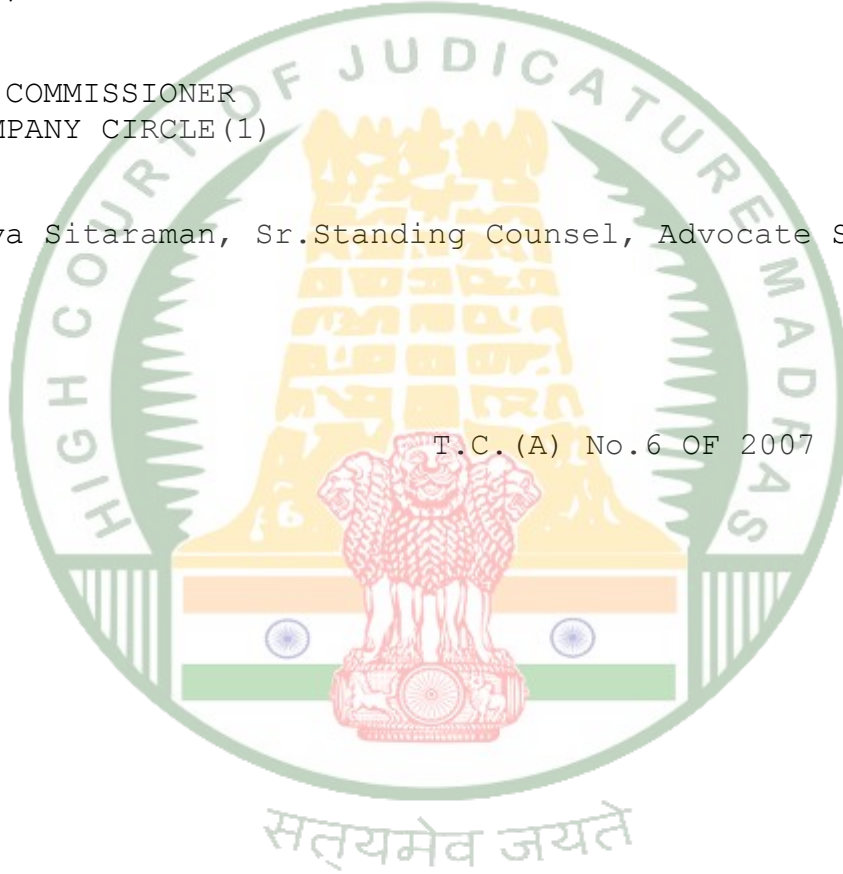
2. THE COMMISSIONER OF  
INCOME TAX, CHENNAI.

3. THE COMMISSIONER OF INCOME  
TAX (APPEALS-III),  
CHENNAI.

4. THE ASSISTANT COMMISSIONER  
OF INCOME TAX COMPANY CIRCLE (1)  
(2) CHENNAI.

+1cc to M/s.Pushya Sitaraman, Sr.Standing Counsel, Advocate Sr 5621

KLT (CO)  
km/14.3.



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